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**DEPOT MAINTENANCE:  
BARRIERS TO PRIVATIZATION**

Graduate Research Paper

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**DEPOT MAINTENANCE: BARRIERS TO PRIVATIZATION**

**GRADUATE RESEARCH PAPER**

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Logistics and Acquisition Management of the

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Master of Air Mobility

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The views expressed in this graduate research paper are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government.

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James A. Spaulding

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## **Abstract**

Action in Congress is attempting to amend the 60/40 (public/private sector) rule for depot-level maintenance activities as outlined in section 2466 of Title 10, United States Code. By increasing the amount of depot-level workload performed by private depots, the DoD hopes to achieve cost savings to pay for necessary force modernizations. In addition, depot workloads may keep many contractors solvent during this period of reduced defense acquisition and spending. An appropriate balance between government and privately owned depots maintains the DoD's core capability, while contributing to a strong military industrial base. A serious imbalance on either side may have the devastating effects of leaving the military unable to fight two major regional conflicts and leaving the industrial complex crippled for years to come.

Without addressing the barriers that directly deter successful privatization, maintenance and repairs costs may continue to increase rather than decrease--jeopardizing DoD modernization plans and further weakening the industrial base.

This research examines three areas: the issues that have increased DoD desires to privatize public depot workloads, the institutional and overarching impediments to privatization and current Air Force depot privatization efforts.

# **DEPOT MAINTENANCE: BARRIERS TO PRIVATIZATION**

## **I. Overview**

Our efforts to make outsourcing and privatization a successful venture across the Air Force will better enable us to focus on our combat functions, take care of our people and keep our modernization program on track as we prepare for the challenges of the future. (14: 37)

General Ronald R. Fogleman, Air Force Chief of Staff

### **Introduction**

The key buzzword when depot maintenance is mentioned today is "privatization." With irrefutable excess capacity held to provide surge capacity during times of war, the Department of Defense (DoD) depots seem to exude inefficiency and monetary waste. This waste directly limits defense dollars available to address other existing threats like aging aircraft systems and the need to modernize our defense base. Proponents of privatization hail the transition to private depots as necessary to providing defense dollar savings for other needed changes, but details of a comprehensive DoD strategic plan to outsource and privatize remain obscure.

Both outsourcing and privatization have been publicly embraced by the Clinton administration as ways to counterbalance shrinking defense budgets and the cost of needed force modernization. Programs such as the F-22, the C-17, the Joint Strike Fighter, and the Milstar satellite system all depend on continued funding to replace aging or technologically outdated systems (35:12). In a letter from the Chairman of the Defense Science Board to Dr. Kaminski, the Under Secretary of Defense Acquisition and Technology, Dr. Fields provides specific recommendations, including privatization and

outsourcing, that "could yield shifts of approximately \$30B per year from support to forces by the year 2002" (13:2). Some of this is expected to come from \$1.2 billion in potential savings from depot privatization efforts over the next five years.

The members of the Commission of Roles and Mission of the Armed Forces expect their recommendations could save 20 percent of the estimated \$15 billion the Pentagon spends annually on depot maintenance activities (33:34). As Joshua Gotbaum, Assistant Secretary of Defense for Economic Security, rationalizes:

When you cut your budget by 40 percent and your personnel strength by more than 30 percent, you simply cannot conduct business in the same old way . . . contracting out work is one solution that industries and local governments have tried in recent years in order to do more with less. Now DoD needs to consider more privatization. (29:42)

### **Importance of the Research**

During the Reagan year's at the height of the Cold War, the U.S. defense budgets, hence the federal debt, skyrocketed in response to perceived threat from the Soviet Union. Since the fall of the Berlin Wall and the breakup of the Soviet Union, the perceived threats have changed. Domestic issues, including the federal deficit, now are seen as threats to our nation. Military operations other than war consume many of the military assets and defense dollars. The role of the United States and the U.S. military in many of these operations has remained clouded. Support from the public is often sporadic and wavering. These issues make it difficult for military advocates to solicit additional funding from the tax base. This shrinking defense funding yields fewer defense contracts to support the military industrial base. This is the environment that finds the commercial defense industrial base eyeing the public depot workload as a substitute for stagnating defense production lines. Allocated defense dollars will be used increasingly for force

modernizations and modifications necessary to extend life-cycles of fielded weapon systems. This modification work will take the place in the depots, and the resultant jobs represent hope for defense contractors. These job opportunities are at the very center of the depot maintenance issues.

## **Background**

Depot maintenance is a key component supporting our national defense and has considerable size and complexity. Depot maintenance includes activities to repair, overhaul, modify, and upgrade defense systems and equipment. In addition, "it can involve the limited manufacture of parts, technical support, modifications, testing, and reclamation as well as software maintenance. DoD estimates that its depot repair facilities and equipment are valued at over \$50 billion (23:13)." In Fiscal Year 1996, the depots were responsible for the support of millions of equipment items, 53,000 combat vehicles, 514,000 wheeled vehicles, 372 ships, and 17,300 aircraft of over 100 different models (21:5). Currently 29 major DoD depot maintenance activities perform depot maintenance, of which 10 are in the process of being closed. Additionally, DoD uses 1300 U.S. and foreign commercial firms to support its depot maintenance requirements. Total budget for the depots for Fiscal Year 1996 was \$15 billion or 6 percent of the \$243 billion budget (21:5).

Along with their roles in supporting national defense, the depots constitute a place of employment for over 100,000 defense civilians. The Air Force employs more than 45,000 in its depots, the Army has about 17,400, and the Navy has around 15,371. In

addition about 19,800 Defense Logistics Agency employees work in distribution depots (3:1).

Another often overlooked reality is the excess capacity maintained at the public depots. At the time of the 1995 Base Realignment and Closing (BRAC) process, the DoD depot system had 40 percent excess capacity based on an analysis of maximum potential capacity for a 5-day week, one 8 hour-per-day shift operation. The Air Force had 45 percent over-capacity (21:5). The need to maintain some slack in any system is acknowledged as a method to respond to surge requirements, but maintaining 45 percent excess capacity is both costly and inefficient. Amazingly, this excess remains after the reduction of nearly 40 percent of the personnel relative to when the depot system was at its peak in 1987 (21:5). The Air Force, in particular, has not closed a single depot since the 1960's, and while personnel have been reduced, the public depot excess capacity remains (21:5).

### **Problem Statement**

This paper will examine the privatization of depot-level repair and maintenance activities and point out some of the issues facing those who are attempting to privatize our excess capacity. Depot maintenance is being widely examined at this time as a means to help fund modernization. Current concerns revolve around the desire to change the so called "60/40 rule" and other legislations favoring public depots. Those in favor of privatization see the repeal of these legislations as critical to provide modernization savings. Those opposed claim increased reliance on the private sector is more risky than maintaining depots under government control. If the public depots maintain the majority

of the workload, private contractors may not survive in this period of budget cuts in order to maintain a strong industrial base. However if the private depots absorb more work, then thousands of public depot employees face job losses. Many barriers to successful privatization efforts, hence force modernization still remain.

Privatization, if done effectively, could save billions by reducing public depot inefficiencies and relying on contractors, whose own specialties include depot maintenance and repair activities. If accomplished ineffectively, the new depot relationships could end up costing more and carry with them the risks associated with poorly written or administered contracts. Instead of saving money for modernization, a bailout of the depot contracts could cost billions.

### **Research Objective**

The research will examine the benefits and constraints of privatizing depot workload in order to answer the research question: Are we privatizing depot maintenance workloads in the best way possible?

### **Investigative Questions**

- 1. What do we mean by privatization and outsourcing?*
- 2. Why does the government want to privatize its depots?*
- 3. What are some of the institutional and overarching impediments to privatization of the public depots?*
- 4. How are we currently privatizing depots and depot workloads?*
- 5. What problems are we still experiencing?*

## **Chapter Summary**

Savings from depot privatization efforts are necessary to partially fund DoD modernization requirements. As the DoD modernizes and modifies its fielded weapon systems, depot workloads are increasing. Contractors see depot workloads as alternatives to production lines that have stagnated from defense cuts and decreased risk of Soviet aggression. Depots maintenance and repair functions are key to the reparable parts pipeline, while employing thousands of government workers and maintaining excess capacity for wartime surge. Reliance on private contractors to perform a greater percentage of depot workload could decrease overall maintenance costs or increase costs and risks.

## **II. Literature Review**

### **Chapter Overview**

This chapter consists of a short section providing definitions of key terms. These terms form the basis for understanding the issues surrounding depot maintenance privatization. This chapter also outlines three assumptions which make privatization of public depots and depot workloads attractive to the DoD. The desire to privatize depot workloads hinges on the validity of the three assumptions about the current depot environment. The DoD must ensure that the environmental conditions called for by the assumptions are present before attempting privatization. Failure to do so raises questions concerning the DoD's ability to meet its privatization goals.

### **The Definition of Terms**

Trying to find a commonly agreed upon definition of privatization is a task in itself. There are probably as many attempts at defining privatization as there are experts in the field. However, coming to a common understanding of what privatization is or is not, and then working from that definition to further define outsourcing and privatization-in-place is paramount.

#### **Privatization.**

The Defense Science Board offers the following privatizing description: "A subset of outsourcing that involves the transfer of government assets (depots, data centers, etc.) to the private sector. Most DoD outsourcing initiatives are not likely to involve significant asset transfers" (8:8). Another definition offered by Kent is, "the

transfer of functions previously performed exclusively by government, usually at zero or below full-cost prices, to the private sector at prices that clear the market and reflect the full costs of production" (28:4).

The Office of Management and Budget (OMB) definition alludes to the efficiency gained by going outside of the organization. "The transfer of government services, assets and/or enterprises to private-sector owners and suppliers, when those owners and suppliers have the capability of providing better services at lower costs" (25:31).

### **Privatization-in-place**

Privatization-in-place essentially requires the contractor performing service to do so on the public site or in the local communities. It normally involves the public lease or sale of existing equipment and facilities to permit the contractor to accomplish the service (29:42). With respect to depot privatization-in-place, the President Clinton's intent was to, "1) avoid the immediate costs and disruption in readiness that would result from relocating of the air centers' missions, 2) mitigate the impact on the local communities, and 3) preserve important defense work forces" (21:17).

### **Outsourcing**

Outsourcing is the transfer of a support function previously performed in-house to an outside service provider (i.e. 'contracting out'). The service provider is usually selected as the result of competition, and the contract is normally subject to periodic re-competition. Usually the service provider is given extensive flexibility regarding how it performs the outsourced function (8:7). As mentioned above, outsourcing usually does not involve extensive amounts of government furnished property.

## **Core capabilities**

Section 311 of the National Defense Authorization Act of 1996 states that core depot-level maintenance and repair capabilities should be performed in facilities owned and operated by the United States. It also states that core capabilities include sufficient skilled personnel, equipment, and facilities that are of the appropriate size to “ensure a ready and controlled source of technical competence, and repair and maintenance capability necessary to meet the requirements of the National Military Strategy and other requirements, and to provide for rapid augmentation in time of emergency” (21:4).

Frank Camm of RAND refers to core competency in a broad sense, denoting, “a capability that an organization must retain in-house to ensure its survival and long-term success . . . organizations would not be what they are if these core competencies did not exist (4:2). The Commission of the Roles and Mission of the Armed Forces defines core as those that “for legal or even constitutional reasons, it would be inappropriate to relinquish responsibility for to an outside source (4:3).

The task of determining exactly what amounts are core and what amounts are non-core with regard to risk aversion and costs has remained a major problem for each of the services. More discussion of core will be offered in Chapter III along with other institutional and legal impediments to depot privatization.

## **Privatization Assumptions**

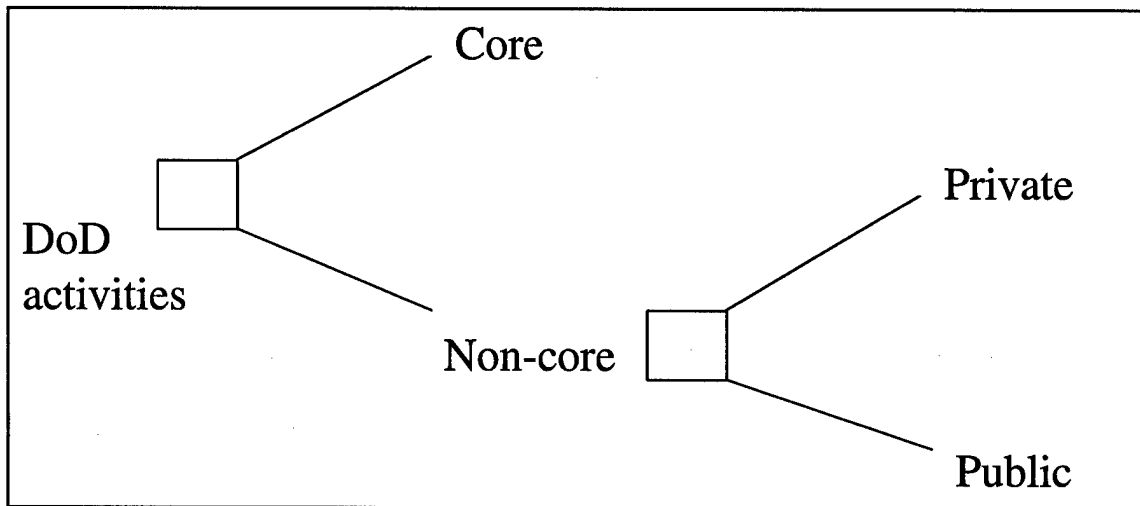
The desire to outsource and privatize much of the non-core workload within the DoD comes from several assumptions. The author will identify three; there are probably more.

### **The Assumption of DoD's Inefficiency at Non-Core Activities**

The first assumption is that the DoD is largely inefficient in performing any non-warfighting tasks. This realization of inefficiency in commercial industry forces many firms to concentrate more on "core competencies" and to outsource those non-core competencies to service providers that claim them as their own core competencies. One privatization author, Janet Rothenberg Pack, calls this, "the belief that the private sector would be a more efficient producer" (41:523). This assumption correlates with the OMB definition of privatization, "... private-sector owners and suppliers that have the capability of providing better services at lower costs" (25:31). Likewise, the DoD's core competencies revolve around a defense strategy that will prevent, deter, or defeat any adversary who threatens us or our allies. Those tasks directly supporting this strategy are core.

The Air Force recognizes six core competencies to support the DoD: Air and Space Superiority, Global Attack, Rapid Global Mobility, Precision Engagement, Information Superiority, and Agile Combat Support (15:1). The sixth core competency encompasses lean logistics and rapid, responsive depot support. By assuming the military is inefficient concerning depot workloads, the decision to outsource or privatize to a cost-effective, efficient expert is logical from the perspective of economy of resources.

A simplified decision tree is used to represent the DoD desire to outsource all non-core activities with the presumption of superior private-sector performance. However as RAND researchers point out, “the simplified presumption in favor of a private source limits any effort to weigh the costs and benefits of public and private sources for any particular support service” (4:3).



**Figure 1: Common Approaches to Outsourcing Follow a Simple Decision Tree (4:3)**

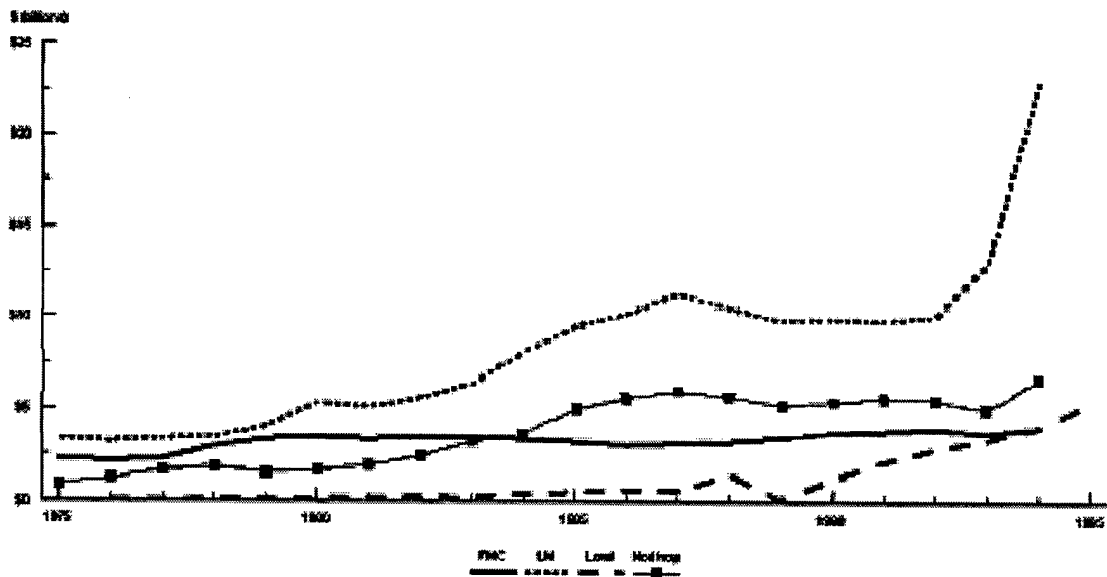
Inherent in the assumption that the military is inefficient, rests the corollary that a provider in the commercial sector will be more efficient--the resultant savings benefiting the government. Unfortunately, as Chapter III will point out, efficiency of operations must be determined on case by case basis, even though current methods of comparison are full of inequities. Without associated private sector efficiencies and those savings returning to the government, transitions to privatization can lead to cost growth and the failure to meet DoD modernization goals.

## **The Assumption of Industrial Base Capacity to Perform**

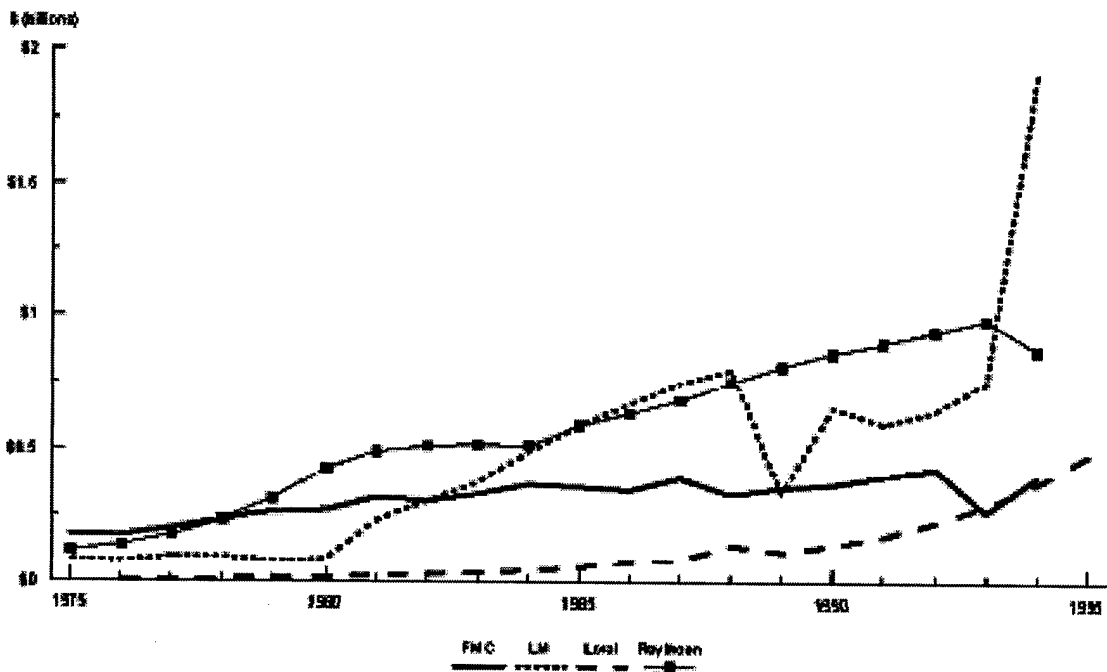
The second assumption that makes outsourcing and privatization appealing is the belief that excess capacity for workload exists outside the DoD in the commercial market. For instance, if the military chose to outsource or privatize an activity that it considered non-core, such as infant daycare, adequate capacity for infant day care in the commercial market would have to absorb the amount outsourced by the military. If excess capacity did not exist outside the military or that capacity was full of risk, the military might have to maintain the capability to perform that function, if it still considered the service essential.

The question, "Is there excess capacity in the private sector?" is difficult to answer. Commercial industry gains little advantage by maintaining "inefficiency". Maintaining over-capacity adversely affects profits, consequently over-capacity is usually minimized where possible. At best the government might evaluate, "Are there likely to be sufficient financially and managerially sound offerors to submit proposals, if a Request for Proposal (RFP) is published by the government?"

The GAO, after discussion with Wall Street defense business analysts, selected sales and cash flow as two financial indicators with which to examine prospective contractors. Other indicators from income statements, such as gross income, operating income, or net income could also be used to analyze the financial viability of the firm in question (22:65). The two graphs below show the rising sales and cash flow for the four top defense firms.



**Figure 2: Financial Indicator of Four Top Defense Contractors: Rising Corporate Sales, 1975-95 (22:65)**



**Figure 3: Financial Indicator of Four Top Defense Contractors: Rising Cash Flow, 1975-95 (22:65)**

The GAO is quick to point out that sales and cash flow appear to be better for some companies than for others. Some explanations for broad differences include how

diversified the company is, the number and extent of Defense segments that a company is involved in, and the transactions associated with business combination or divestiture activity. "Some of the largest changes shown in the figures reflect merger and acquisition activity, such as the growth in sales and cash for Lockheed Martin . . ." (22:69).

Clearly the DoD must ascertain if contractors have the capability and desire to perform contracted depot work. Related to this is the issue of ensuring that we do not lose further capability in commercial industry because of our decreasing budgets. Martin Marietta's CEO, Norm Augustine, expounds on the industry concerns: "To understand the industry's current difficulties, you need to look not at the 35-percent overall drop in real defense spending, but at the nearly 70-percent decline in procurement spending since the mid-1980s (49:2)."

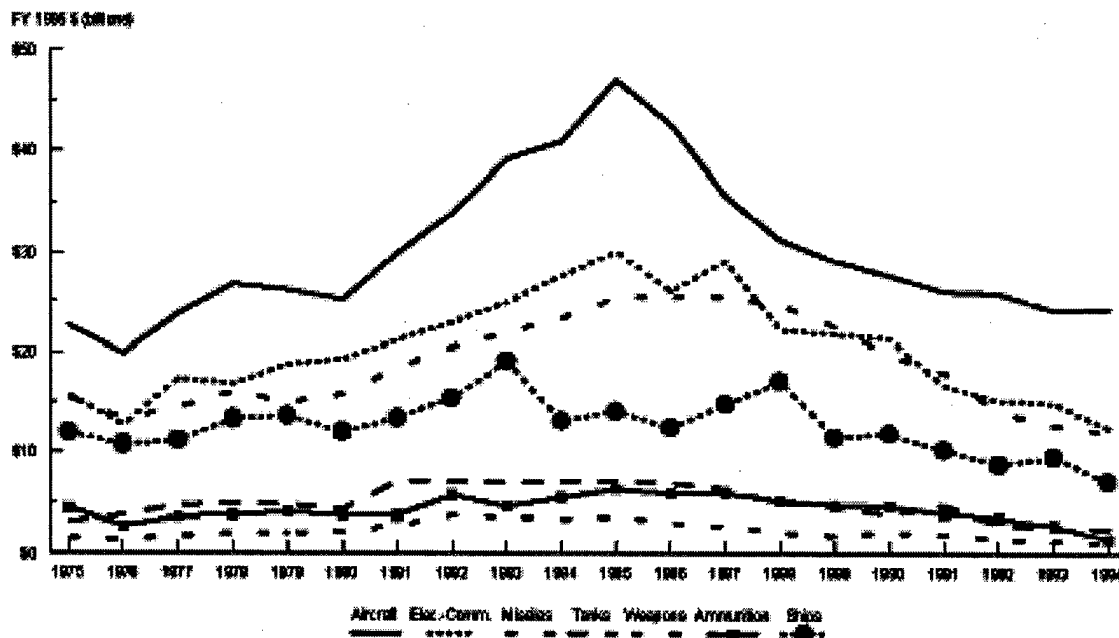
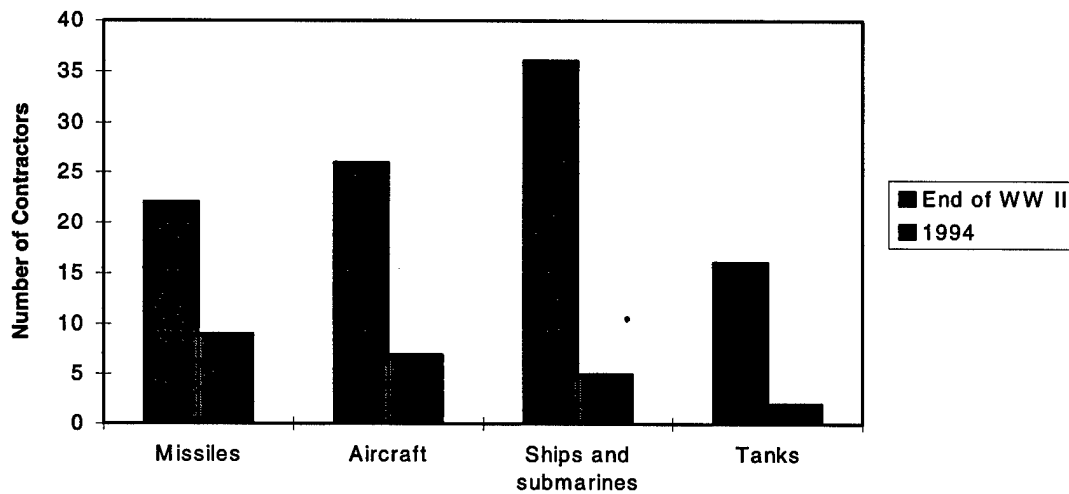


Figure 4: DoD's Procurement Contract Awards by Major Program, 1975-94 (22:11)

With the increase of defense spending in the 1980s came a growing number of defense contractors. Coupled to this increase in the 80s is the resultant drawdown now that defense dollars are scarce. Firms need to improve efficiency and decrease in size and number, so that those remaining are strong enough to compete in the world market and support the nation. Assistant Secretary of Defense for Economic Security, Joshua Gotbaum, explains:

The role that Economic Security plays within this is trying to make sure that the effect of that lower budget is not to lose industrial capabilities that we depend on . . . Some of those suppliers are actually at risk. Some of them will choose to leave the defense business, or to do other things, or to close down lines we want . . . The task is determining what capabilities we really need, what capabilities are genuinely at risk, and then what's the best and most effective way to deal with the government. (34:31)

Despite the increased merger activity in the industry and fears concerning the number of contractors that will be left to compete in the market, there is optimism that the remaining firms will be stronger. As Anthony Velocci, Jr. points out in Aviation Week and Space Technology, "the more diversified a company's business base, the less likely that program cutbacks or cancellations can hurt revenue and profitability" (48:89). Risk diversification has become especially important with defense spending at a low-point.



**Figure 5: Number of Defense Contractors From the End of WW II to 1994 (22:64)**

It should not, however, be automatically assumed that viable financial positions will guarantee that contractors will bid on depots contracts. Contractors bid on contracts in an effort to make profits for the shareholders. If contracts do not provide adequate incentives to private sector providers, then competitive bidding activity will not occur. As Chapter III will point out, competition between and among private and public depots is critical to providing privatization savings. The government must ensure that offered contracts provide sufficient incentives to private performers and carefully monitor the number of potential offerors that remain in the marketplace.

#### **The Assumption That Savings Will Fund Force Modernization**

The third assumption that gives outsourcing and privatization merit is the promise that savings achieved can be applied to modernization of defense programs. In a signed memorandum for the Military Service Secretaries from John White, the Deputy Secretary of Defense, his guidance and “promise” is made explicitly clear:

I expect each of you to make outsourcing and privatization a priority within your Department. I further expect that you will reflect your outsourcing and privatization plans in your FY 98-03 Program Objective Memorandum and highlight these plans in your POM presentation to the Defense Resources Board. Resources saved through these initiatives during the POM process will not be decremented from your outyear budgets and should instead be applied to your modernization priorities. (10:Appendix 2)

It is not clear is how the promise can possibly be guaranteed. Each service's Program Objective Memorandum (POM), as adjusted by the Program Decision Memorandum (PDM), that is issued by the Secretary of Defense for that service, becomes the Budget Estimate Submission (BES). Even after the budget is defended in the joint Office of Management and Budget/Office of the Secretary of Defense review, this budget still only represents the Department of Defense's desires.

During Budget Enactment the President's budget is subjected to all the activities of the Congress, which decides the parts of our national resources that will be devoted to Defense (including all the Services) and how much will be devoted to non-defense activities (7:28). Any resources saved through privatization or outsourcing simply represent less deficit spending for that particular year.

For Fiscal Year 1997, the Concurrent Resolution of the Budget provided for a deficit of \$234.1 billion. (5:117) An anticipated \$1.2 billion saved due to privatization and outsourcing is not true "savings," the same way the peace dividend is not true savings. Both simply represent decreases in the amount of overspending. Will Congress agree to earmark such "savings" for DoD modernization? Or will DoD budgets simply be reduced in following outyears based on anticipated savings? History suggests the latter. This author has found no evidence of unilateral congressional support to privatize

and allocate savings for defense upgrades rather than on other discretionary spending or even deficit reduction measures.

## **Chapter Summary**

This section began by providing working definitions of several terms, necessary to the discussion of depot privatization issues. Understanding that privatization is not privatization-in-place is crucial to appreciating the impact of our current privatization efforts.

Following the definitions, three assumptions were offered. The DoD is approaching depot privatization based upon the validity of these assumptions. The assumptions are: 1) the military is inefficient in non-core capabilities (like non-core depot maintenance workloads); 2) commercial contractors have the capability and interest in performing depot contracts and will do so more efficiently and costly effectively than the public depots; and 3) privatization "savings" will be funneled back into modernization efforts for the DoD.

Are the public depots less efficient than private counterparts? Will sufficient numbers of contractors survive this era of decreased defense budgets in order to compete for future contracts? Will any savings result from privatization efforts, and will they be earmarked by Congress for modernization? If the answers to any of these questions is "no", then the DoD will probably not achieve its modernization goals by privatizing its public depots. If the answers to all of the questions are "yes", then DoD should proceed with privatization. Unfortunately many institutional and legal barriers still remain which

may impede DoD's efforts towards successful depot privatization and force modernization efforts. Some of these barriers will be presented in Chapter III.

### **III. Obstacles to Depot Privatization**

#### **Chapter Overview**

While the desire to reduce excessive spending on inefficient portions of the organization is noteworthy, numerous barriers stand in the way of privatizing DoD depot maintenance. None of these barriers are insurmountable, however many involve complex issues that must be identified and resolved before successful privatization can occur. This chapter presents some of the many issues, both legal and institutional, to further set the stage for examining how the DoD is approaching privatization of its depots.

The reader will notice that since the issues are so tightly interrelated, discussion of any particular issue is not contained in a single designated section. No confusion was intended on the part of the author. Instead the reader should recognize that no issue is dissociated from the others, and together they present challenges to be overcome.

#### **Statutes Effecting Depot Maintenance**

By definition, the privatization of depots will require the use of commercial service providers to perform the work currently accomplished in-house. It should come as no surprise that the DoD has relied on the military-industrial base to perform portions of the depot workload for years. In fact, several statutes have historically influenced the Department of Defense's allocation of depot maintenance workload between government (public) and private performance.

As early as 1974, Congress established legislative statutes regarding the allocation of depot maintenance and repair between the public and private sectors (23:23). Section

2462 of Title 10, United States Code, requires that the Department of Defense obtain services from private firms when those firms can provide them at lower cost. In addition, Section 357 of the National Defense Authorization Act for Fiscal Year 1996 requires that the Secretary of Defense endeavor to obtain commercial products and services from private sources (10:18).

Department of Defense Directive 4151.1, "Use of Contractor and DoD Resources for Maintenance of Materiel," directs the services to plan to conduct not more than 70 percent of their depot maintenance in DoD depots, in order to maintain a private sector industrial base (21:6). Specifically, it outlines that contractor support should be considered when it would: "(1) improve the industrial base, (2) improve peacetime readiness and combat sustainability, (3) be cost-effective, or (4) promote contract incentives for reliability and maintainability (23:24)."

In 1992 the focus shifted to public depot protection, and DoD Directive 4151.1 was superseded by an amendment to Section 2466 of the U.S. Code, Title 10 that established the limit of private sector depot-level maintenance workload at 40 percent. That portion of Section 2466 of Title 10, United States Code, also known as the "60/40 rule," prohibits the use of more than 40 percent of the funds made available in a fiscal year for depot-level maintenance or repair for private sector performance.

Beginning around the same time period, other statutes were introduced to limit the percentage of work accomplished by contractors. "It is not surprising that a bipartisan 'depot Caucus' on Capital Hill with 40 core member has been able to enact a series of depot-protection measures over the years," suggests James Kitfield in Government Executive. If one examines the arguments on both sides of the depot debate, one of the

prevailing themes remains jobs. Paul E. Taibl, the director of Economic Security Programs for Business Executives for National Security, condenses the argument.

"Because of the tremendous number of jobs involved, depots are a political football that players in the affected states will fight tooth and nail to protect" (29:43).

Many of these depot protection laws directly deter the DoD's privatization efforts and hence jeopardize hopes to apply savings to modernization. Section 2464 of Title 10, United States Code, states that it is essential for the Department of Defense to maintain a ready and controlled source for mission-essential maintenance by establishing depot-level repair capability within its own depot system (23:6). This particular statute provides for a "core logistics capability" that must be identified by the Secretary of Defense and maintained by the DoD unless the Secretary waives DoD performance as "not required for national defense (21:6)."

The DoD's new policy regarding depot maintenance is reportedly determined to decrease the maintenance workloads assigned to DoD depots by the following actions:

(1) size depots to a minimum core workload, (2) limit public-private competitions to relatively minor and obsolete workloads, (3) reduce other depot work by the amount won during competitions, (4) restrict depot's ability to obtain new workloads, and (5) apply best value concepts only for last-source workloads and other work the private sector cannot or will not provide. (19:14)

This policy would limit the amounts of depot work performed by public depots to a predetermined core level, not an arbitrary 60 percent. In addition, it provides the maximum amount of work possible to the private depots in order to support the military industrial base.

Another statute, Section 2469 of Title 10, United States Code, states that DoD-performed depot maintenance and repair workloads valued at not less than \$3 million

cannot be changed to performance by another DoD activity without using “merit-based selection procedures for competitions” among all DoD depots, and those workloads cannot be changed to contractor performance without the use of “competitive procedures for competition among private and public sector entities” (21:6).

### **Current Public-Private Workload Split**

In 1995, the Department of Defense reported that around 28 percent of maintenance expenditures went to private contractors and 72 percent went to public depots. A General Accounting Office (GAO) report in 1994, however, showed that the percentage of private sector work was much greater. The GAO reported that “over half of DoD’s depot maintenance expenditures go to the private sector when the costs of repair parts or various technical or repair services the depots purchase from the private sector are included” (23:24).

Analysis by the GAO showed that funds for interim contractor support, contractor logistics support, or goods and services that DoD depots ultimately buy from the public sector were not included in DoD estimates (21:7). Clearly, determining the exact breakdown between public and private workload must begin with a definition of those expenditures to be included and those excluded.

The DoD desire to privatize its “non-core logistics capabilities” is dependent on repeal of the regulations listed above. With goals of privatizing Kelly and McClellan Air Logistics Centers by 2001, the “60/40 rule” and others like it impede privatization timelines. The table below found in a Report to Congress by the Office of the Secretary of Defense shows the projected Air Force depot-level workload between FY97 and FY01.

**Table 1**  
**Air Force Depot Maintenance And Repair Workloads, FY1997 - FY2001 (9:22)**

Distribution of Programmed Funding for Air Force Depot Maintenance And Repair Workloads* Accomplished By Federal Government Personnel And Non-Federal Government Personnel (Constant FY1996 Dollars in Millions)					
	<u>FY97</u>	<u>FY98</u>	<u>FY99</u>	<u>FY00</u>	<u>FY01</u>
Total Workload	3,700	3,604	3,764	3,815	3,712
Public Workload	2,421	2,054	1,834	1,755	1,710
Private Workload	1,279	1,549	1,930	2,060	2,002
(Percent)					
	<u>FY97</u>	<u>FY98</u>	<u>FY99</u>	<u>FY00</u>	<u>FY01</u>
Public Workload	65	57	49	46	46
Private Workload	35	43	51	54	54
Note: Table may not add due to rounding					
* These data do not include programmed funding for the depot maintenance-related portions of Interim Contractor Support (ICS) or Contractor Logistic Support (CLS).					

### **Efficiency Achieved by Eliminating Jobs**

As mentioned earlier, one of the major obstacles to be overcome through the privatization process is the political dilemma of lost jobs. Depot privatization offers no political panacea when it promises reduced costs, as one industry executive points out:

There are basically three ways industry can accomplish the same work at less cost than the government. One is to expand the business, so it's sharing fixed-costs over a larger business base. Second is to pay people less. Third is what we call streamlining, which means having fewer people do the work. (29:62)

These are the words of harsh reality that many politicians are not yet ready to face.

As L. R. Jones, professor of financial management at the Naval Postgraduate School in Monterey, summarizes:

When the DoD has proposed reductions . . . members of Congress whose constituents are to be affected press DoD to cut in other areas, imposing the burden of reduction on the constituents of other member of Congress. Thus the game of dodging the budget-cutting bullet continues. (27:13)

This sentiment was echoed by a Senate committee staff member: "Although privatizing agencies is a popular ideas within the new Republican-controlled Congress, members with public depots in their backyards would battle the idea" (3:1).

The efforts to privatize-in-place at the San Antonio Air Logistics Center point to exactly this kind of political concern. The GAO reported in an 1996 report on depot maintenance that the Base Realignment and Closure Commission's recommendation to close San Antonio ALC, including the depot, "gave DoD an opportunity to improve the cost-effectiveness of its depot activities (23:7)." However, the political impact of the decision to close the Air Logistics Centers and depots at both Kelly and McClellan AFB was shocking, since over 30,000 jobs were instantly threatened, including those belonging to 45 percent of all Hispanic Americans working for the Air Force (29:42).

As Frank Camm from RAND points out in a recent report, "DoD should recognize that not everyone will benefit from privatization, even if it is outstandingly beneficial for DoD as a whole" (4:52).

### **Overcoming Desire for Military Control**

If the many statutes could somehow be amended to ease the legal barriers to privatization, the privatization debate would still continue over control resting with the government or civilian industry. DoD's tendency to outsource and privatize to the maximum extent possible stems from the assumption that great benefits will occur under private control. Many perceive civilian control of the depots as risky or inherently new,

but civilian control of the military finds its roots in the Constitution. "All three of the independent branches of American government are headed and controlled by civilians, at every level, and at all times--peace and war--with the single exception of martial law, exercised only temporarily in specific areas under specified conditions, and then instituted by civilian authority (30:11)."

Richard Kohn, in the article "Uncivil Relations--The Civilian-Military Crisis," relates that civilian control in the military traverses all areas. "Civilians decide the kind of weapons to build and forces to have, how many of them and how to get them, where to deploy them, and under what circumstances they will be used (30:11)." He poses the analogy that civilians possess not only all the face cards and all the trumps, but they make up the rules of the game.

With respect to military weapons systems, civilian control of logistics functions has become more commonplace as time has progressed. A policy memorandum issued by the Deputy Under Secretary of Defense in November 1993, stated that it is not core policy that all mission-essential hardware be maintained in a DoD depot. The memorandum makes allowances for private sector depot maintenance, "if a service is satisfied that reliable sources of repair exist in the private sector to negate risk to the weapon system (23:22)."

The KC-10 aircraft, although a high priority system and required for the accomplishment of the two-major regional conflict (MRC) objective, depends on contractor maintenance for the life of the aircraft. Because of similarity with its commercial counterpart, the DC-10, the DoD feels that contract maintenance actually

mitigates risk (23:22). This same logic is embraced by proponents of depot privatization, who would like to see greater private sector involvement.

### **Need for DoD Culture Change**

This transfer from government control to private control will not occur overnight, since large organizations characteristically avoid change. As Frank Camm of RAND points out, "commercial firms that have aggressively reevaluated which work to do in-house and which to contract for have faced a profound culture shift" (4:42). DoD undoubtedly will be no different. Programmed organization changes such as Total Quality Management and even service uniform changes have met with varying degrees of acceptance. As a result, the DoD should expect that without successful, early privatization efforts and culture change, more comprehensive plans, such as the privatization of Kelly and McClellan depots, will meet with acceptance problems.

The transition to private contractors raises a whole set of areas where the DoD has traditionally shown poor aptitude. In the areas of cost accounting, writing and managing contracts, the DoD has had its share of problems. Not to mention that forming long term relationship with suppliers and contractors requires the Air Force to compete well and equitably manage contracts to ensure best performance is achieved at reasonable cost. Large scale successful privatization and outsourcing is simply not yet a core competency of the Air Force. If the DoD endeavors to achieve savings through privatization, the Department must change how it does business.

## **Strategic Relationships with Suppliers**

Forming long term relationships with industry requires understanding and trust at its outset. Both industry and the government recognize that they must work to achieve that understanding. The Assistant Secretary of Defense for Economic Security, Joshua Gotbaum, explains:

What we've found in case after case is that we need to teach language, convention, techniques, so that more than in the past, people in the Department of Defense and people in industry can understand each other--recognizing the fact that both of them are undergoing massive change. (34:2)

A recent RAND Memorandum pointed out that to be an effective buyer of services, "the Air Force must view contracting for services as a core competency" (36:7). The memorandum also noted that providers have the responsibility, "to give the Air Force the best possible access to the provider's own competencies" (36:7). Can the Department of Defense successfully compete against industry for depot workload while trying to foster these long term relationships? It appears that the Department of Defense has decided it cannot. The policy of limiting competition between public and private depots grants more work to private industry, but discounts the benefits of government bidding to encourage efficiency.

Many of the savings offered from outsourcing and privatization arise from competition, both among private industry service providers as well as competition between public and private providers. As providers of services compete for performance contracts, they develop processes to improve performance and efficiency, reducing their internal costs, and leading to competitive, cost effective bids.

In the past, competition between the public and private sector was seen as beneficial to forcing both public and private depots to increase efficiencies and reduce costs. As recently as 1993, Air Force General Ronald Yates, the service's procurement and research chief, vowed to drive down DoD repair and maintenance costs by increasing competition between public and private depots (47:2). However for years, industry has sought to end private-public competition. The commercial industry has seen competition between public and private ventures as "unfair", since many factors, such as cost of capital, tax advantages and Office of Management and Budget (OMB) Circular A-76 cost margins, are in the government's favor (21:10).

Don Fuqua, president of Aerospace Industries Association (AIA), addressed the Readiness Subcommittee of the U.S. House of Representatives Armed Services Committee to denounce private/public competition. "Non-core workload, particularly modifications and upgrades, should be carried out in the private sector to save money and preserve an adequate industrial base. Once this balance is achieved there is no need for public/private competition" (12:42). He criticized the plan to increase competition as "an inequitable situation" and part of the "growing nationalization of the U.S. aerospace industry" (47:2). The DoD discontinued public-private competitions arguing that the depot accounting systems are inadequate to capture all of the related costs (21:11).

### **Risks of Failure**

Many skeptics of privatization and outsourcing efforts by the Department of Defense point to the risk of relying on private depots. Rep. Jim Hansen, R- Utah, the co-chairman of the depot caucus voiced his privatization concerns:

We see privatization in place as the first step towards John White's vision of a 100-percent private depot system, which would be a disaster for the Defense Department. The services have a real requirement of a ready, controlled source of maintenance, because when it comes time for war they can't afford to start renegotiating contracts. (29:43)

This fear that private contractors may not be able to respond in a timely manner to the Defense Department's rapidly changing wartime requirements can probably be minimized. In the Policy Regarding Performance of Depot-Level Maintenance and Repair, the core public depot capability requirements are explained in terms of three basic risks--readiness risk, sustainability risk and technology risk. The report defines each of the risks as follows:

**Readiness Risk:** The risk that the absence of timely depot capability will compromise operational readiness. This readiness-driven core capability requirement involves the capacity to perform scheduled industrial maintenance actions such as overhaul, calibration, and component rework, as well as unscheduled depot-level repair actions.

**Sustainability Risk:** This risk that the industrial base will not have sufficient depot-level competencies and capabilities to ensure that mission essential weapon systems can be repaired and maintained to support contingency operations and meet the time constraints imposed by the JCS scenario. Sustainability core capability requirements typically include those required to perform unscheduled maintenance actions that are beyond the capability or capacity of intermediate maintenance activities (e.g., crash/battle damage repair; emergency, high volume repair of mission essential components (surge); and emergency manufacture of critically needed repair parts).

**Technology Risk:** The risk associate with the absence of technological knowledge and awareness. Modern weapon systems are extraordinarily complex and the Services must maintain an organic capability to understand, master, and support current technology. (11:9)

To properly manage overall risk, each of the three types of risk must be carefully assessed and dealt with. The policy goes on to state that the DoD must efficiently maintain core capabilities, organic depot facilities, equipment, and personnel resources to

ensure a ready and controlled organic source of technical competence (11:9). Logically, the only way exercise these capabilities for wartime use would be through a broad range of peacetime depot maintenance workloads.

Herein resides the question of DoD core activities. What is the minimum depot capability that the DoD should retain to ensure organic support? Is organic support necessary except as risk protection against commercial industry? These questions are beyond the scope of this paper, but answers must be determined. One certainty is that as decision makers assess risk, it must be performed in a manner unrestricted by the current budget process. After a comprehensive strategic plan is formulated, the DoD can privatize or outsource to reach those strategic goals within actual budgetary constraints.

A Congressional Budget Office study, Public and Private Role in Maintaining Military Equipment at the Depot Level, indicated that the presumption that only public depots could provide the level of support for equipment required under the Joint Chiefs of Staff's scenario, "does not appear to be well-founded" (33:38). The report states that concerns regarding performance measure of quality and timeliness do not necessarily stem from a conviction that private depots are less competent. Instead, the concern surfaces since private firms are more intent than public facilities on holding down costs.

Much of this concern could be reduced by forming long-term customer relationships with suppliers. As was previously mentioned, these relationships must have trust and understanding as cornerstones. As private contractors strive for their own efficiency and quality improvements, they not only cut costs, but suggest ways that the government could cut costs. This type of relationship is difficult, if not impossible, to form when contracts are periodically re-competed to attain the best price. Under periodic

recompetition for the work, tasks can be frequently moved between firms, leading to start up costs and problems associated with unfamiliarity with tasks. While attempting to achieve best-price, often the result is learning-curve-production as a firm tries to fulfill its contract and remain competitive for further recompetition.

The Congressional Budget Office suggests that the DoD could overcome the need for new contractors by maintaining dual (or multiple) sources for each workload and allowing those sources to compete for larger shares (33:38). In this way each maintains the capability and familiarity with the work performance, yet each can force its competitors to cut costs and remain competitive for greater workload. Although economies of scale may not be achieved since work is spread out between firms, competition between firms should keep bids for new workloads lower than sole-source.

Wartime surge capability fears may be unfounded if one looks at surge capability requirements. DoD has maintained public depots in part because it believes that, unlike private sector firms, the depots should maintain excess capacity in peacetime expressly for surge purposes. While it is true that this surge capacity exists in the public sector, it is not clear whether the burden of this kind of capacity to meet wartime demands is intentional. According to the CBO, the current Air Force policy assumes that private producers are able to surge to 150 percent of their peacetime workload whereas public depots are able to surge to 160 percent (33:39). The level does not differ by much given any degree of uncertainty surrounding the surge estimates.

The risk of poor-quality contractor work could be mitigated by specifically expressing desired quality of work in the contract, and accurately determining measurement areas for contract compliance. As a result, DoD may have to monitor

private firms carefully to ensure quality. As simple as this sounds, the mechanics are still rather new to the DoD. As the RAND Report, Expanding Private Production of Defense Services, points out, "it has been notoriously difficult for DoD to enforce performance-type warranties--warranties that guarantee that a system will realize a certain standard of performance in operation rather than passing an acceptance test at the time of acquisition" (4:32).

### **Lack of Good Cost Accounting in Public/Private Competitions**

Another of the assumptions previously mentioned that drives the move towards privatization is that commercial industry can perform more efficiently and economically than the public depots. Much of the research uncovered has hinted the opposite is true--that the public depots actually cost less than private depots in the military industrial complex. According to Jim Davis, president of the American Federation of Government Employee Council 214:

The public depots are cheaper, and I think every study has shown that. It's also been proven through competition. When the Air Force bids against private contractors, the Air Force wins. We don't have to make a profit . . . We don't pay CEOs multi-million dollar salaries. We don't have massive cost overruns. (3:1)

In a statement to the House Committee on National Security, David Warren, of the GAO, outlined the results of 12 DoD buying activities surrounding public-private competition for depot maintenance and contracting actions for depot maintenance work. As a result of the GAO review, it was determined that 67 percent of the 95 non-ship competitions were won by public depots, "with public sector bids averaging 40 percent less than their closest private sector competitor" (21:4). For 23 percent of the competitions between public and private competitors there were no offerors from the

private sector, and for 35 percent there was only one private sector bidder. In addition, of the 240 active depot maintenance contracts examined, the GAO found that 182 (76 percent) were awarded sole-source, and 86 percent had 4 or fewer competitors (21:4).

Under the Department of Defense's new depot system policy, the DoD depots would be used sparingly for public/private competition since the depots could not compete for non-core workloads whenever "adequate private sector competition" exists even though they may offer the most cost effective source of repair (21:4).

In testimony before Congress, David Warren remarked that numerous tangible costs associated with privatization-in-place do not pertain to DoD depots. "Our analysis indicates that unique requirements such as the cost of proprietary data rights, contractor profits, and contractor oversight could add 20 percent, or more, to the cost of performing the work (21:17). He also pointed out that the public sector won about half of the competitions for commercial activities under the Office of Management and Budget (OMB) Circular A-76, and the resultant savings were a result of competition rather than privatization (21:3). Furthermore, he stated that the competitions won by private sector involved activities that more readily lent themselves to private sector competition. "These activities--unlike depot maintenance--generally required low-skilled labor, uncomplicated and repetitious work tasks, small capital investment to enter the market and were common to the private sector (21:3)."

A review of A-76 competitions where the private sector did win showed that military costs, such as military pay and benefits, when coupled with productivity losses due to additional duties resulted in increased cost and decreased military competitiveness.

Depot maintenance, conversely, is performed almost exclusively by civilian, not military, personnel. (21:13)

Whether private or public sector wins the competition comes down to the bids that each puts forth. Unfortunately the cost figures that DoD uses to compete do not include all of the same costs which industry is forced to use. Public depot bids should reflect all fixed and variable costs of operations, but there appears to be little cost reflectivity. For instance, if a public depot underbids a contract in which the private contractor accurately prices all costs using an acknowledged accounting method, such as Activity Based Costing, the public depot would win the contract because it bid the lower price. The public depot might have little regard to actual costs until well into contract performance. Any losses incurred by the public depot are passed on to the federal debt.

An issue brief arising from the NSIA Workshop on Privatization and Outsourcing drives home this point. "Achieving fairness in public/private competitions is difficult because there is no such thing as a public-sector fixed-priced contract since the public sector bids are analogous to private sector cost-type bids in that all costs incurred are paid by the taxpayer" (37:10).

Most government contractor-supported programs are written using fixed-price contracts. In basic terms that means the government pays a price equal to the firm price specified as a term in the contract. According to the Armed Services Pricing Manual:

The contractor's ability to avoid a loss or make a profit under the fixed-price arrangement is directly related to its control of the costs of performance . . . The contractor assumes responsibility for [any higher] cost with the degree of responsibility determined by the particular type of fixed-price arrangement negotiated for the desired acquisition. (46:3)

The contractor assumes most of the risk of the fixed-price contract by ensuring that it does not underbid the contract and has the ability to perform. If it cannot perform as required under the fixed-price, then the contractor (and shareholders) suffer financially. Added to other aforementioned factors, such as taxes, and the playing field seems to noticeably tilt in favor of the government.

Competitive results where the public sector has underbid private contractor may be the result of bids that did not cover all fixed costs, or it could be the recognition by the government of a more efficient way to perform. As David Warren states,

If you simply assume that government is inefficient, then privatization makes sense. But what if you happen to have an efficient government operation? The bottom line is you should proceed with privatization on a case-by-case basis, and take sufficient time to fully understand in each case what the cost savings are really going to be. (29:44)

### **Shrinking Competitive Industrial Base**

As defense dollars for acquisition and production have steadily decreased, an ideal solution would be for industry to convert some military facilities to the production of civilian goods and services, using the same workforce; however as Lawrence Korb, pointed out, that is easier said than done:

The large defense contractors essentially operate without market discipline. They emphasize performance not price. Cost overruns, high salaries and corruption are common. Their only customer, the Pentagon, has a vested interest in seeing that they survive to protect the military's industrial base. (31:7).

However Don Fuqua, president of Aerospace Industries Association, expressed his concern about the future of the industry base: "The whole nation should be concerned because virtually all of the design, engineering, production and system integration

capabilities needed to preserve America's technological edge in combat reside within the private sector" (12:42).

Since converting to civilian workload is difficult, especially in time of slow economic growth, the only answer to survival for many firms is consolidation. Jon Kutler, president of Quarterdeck Investment Partners, Inc., remarked about the seemingly weekly announcements of acquisitions in the defense industry: "Today's deals are driven instead by quantifying savings obtainable in consolidating facilities in an industry which still retains far too much capacity" (32:2).

Consolidation can be advantageous in controlling costs, if the consolidation eliminates excess, unused capacity. This unused capacity equates to excess overhead which adds no value to production while increasing unit costs. The Assistant Secretary of Defense for Economic Security, Joshua Gotbaum, explains,

If two companies are producing the same missiles for DoD on a cost-plus basis, and each of them has a plant that is operating at 20 percent of capacity, an organization is paying for the 80 percent that is fallow in each plant-in this case the Department of Defense or the taxpayers of the United States. . . If the two companies combine, and . . . create instead one plant that's working at 50-60 percent, then we as taxpayers and the Department of Defense are better off. (34:3)

However as two large companies combine, they reduce the number of bidders for future ventures. Martin Marietta's CEO, Norm Augustine, pointed out that while the world is changing and the defense industry needs to shrink, further reductions could be dangerous: "Since the fall of the Berlin Wall, we've lost more than a million jobs, and the industry is now consolidating at a furious pace. The defense supplier base has imploded, with some numbers suggesting a shrinkage from about 120,000 firms a decade ago to 30,000 today [Mar 1995]" (49:4).

In addition to lost jobs, plant closures, and joint marketing, Mr. Gotbaum, speaks of the risks to competition due to consolidation in the industry:

“The other consideration is that as companies consolidate, we run the risk that we might end up being dependent on a single supplier. And that poses competitive risks because competition is the juice that lowers cost. Competition is the juice that encourages innovation. And so we are mindful that in any combination, there is a risk that we may up being at the mercy of a single supplier. (34:3)

### **Poor Cost Savings with Few Competitors**

Perfect free market competition may hold the promise of reducing costs as the depots are privatized. Under a free and competitive market, the traits attributed to competition are those that arise when supply and demand are in a state of equilibrium.

Unfortunately, the depot system is not a free market system, as the Armed Services

Pricing Manual points out, because supply and demand are not in equilibrium.

They hardly ever are [in equilibrium], particularly in the markets for military goods and services [since] specially created military specifications restrict the opportunity for competition. The law of supply and demand produces effective competition (and control) only when what is being bought and sold is offered by many sellers. (46:3)

While direct competition between public and private depots has been minimized in light of the new depot maintenance policy, the DoD still needs a method to compare costs between the private and public sector. In the Secretary of Defense's Report to Congress on the Policy Regarding Performance of Depot-Level Maintenance and Repair, the need for comparing costs was articulated: “The Department continues to strive to develop a means to compare organic costs for depot maintenance with cost in the private sector for those limited situations where there is not adequate competition in the private sector” (11:33). Unfortunately the differences between public and private sectors make

such a comparison difficult. The Defense Depot Maintenance Council (DDMC) sponsored a committee that authored the Cost Comparability Handbook, which endeavors to relate costs, so that DoD depot maintenance operations can at least be compared or benchmarked with the private sector if appropriate (11:34). Unfortunately without methods of accurate accounting, successful competition between and among public and private depots may remain unreachable, along with associated cost benefits.

### **Chapter Summary**

This chapter began by outlining many of the past and present regulatory statutes which govern the way in which private and public depot workloads are allocated. Clearly the intent to widely privatize the depots requires the repeal of the current legislations setting arbitrary guidelines on sector workloads. However changing legislation alone cannot bring about successful privatization without addressing the other barriers and ensuring an environment favorable to privatization.

The chapter presented points about the efficiency of private and public sector operations. The assumption about the greater efficiencies achieved by the private sector may depend on the accounting system used--government's or private sector's. Until public depots can be fairly compared to private counterparts, the current accounting practices lead to questionable efficiency claims.

Without common accounting standards, true competition between public and private service providers remains unreachable, limiting savings that can be obtained through privatization. Worse yet, the DoD may unknowingly privatize those operations which are actually more efficient than private sector can provide, while holding on to

inefficient ones. Presupposing in favor of the private source for non-core activities does not address cost-effectiveness, the contracting policy or implementation method used.

Recall also the assumption about the availability and capability of the public sector to perform depot maintenance workloads presented in Chapter II. This assumption requires the financial well-being of private sector providers and points to some of the risks involved in relying on the private sector. Mitigation of risks through strategic alliances and well written and administered contracts is absolutely essential.

Additionally, the DoD must carefully monitor the number of private contractors competing against each other if the government continues to take part of the depot workload and perform in-house. Evidence shows that competition is the key ingredient for true privatization savings, and these savings will not occur with the majority of contracts being awarded to original equipment manufacturers or with only limited competition.

Chapter 4 will present evidence of the steps towards public depot privatization the DoD has used and is currently using at Newark, Kelly and McClellan Air Force Bases.

## **IV. Depot Privatization Efforts**

### **Chapter Overview**

After Chapter 2 reviewed the assumptions that have caused the DoD to attempt privatization, and Chapter 3 outlined some of the organizational and legal impediments to privatization, Chapter 4 examines how we are currently privatizing our Air Force depots. By examining our current efforts in light of the assumptions and barriers in place, the reader can judge our current privatization plans.

### **Newark Air Force Base**

Newark AFB represented the DoD's first attempt at large scale privatization efforts. Many of the issues encountered by those seeking privatization are exactly those described earlier in this paper. Some issues have been overcome, but others still cause concern to those who evaluate the decisions and methodology used in privatizing public depots.

Newark AFB supports two Air Force missions, depot maintenance and metrology and calibration. To fulfill its first mission, the Aerospace Guidance and Metrology Center (AGMC) provides the depot level maintenance and repair of "inertial guidance and navigation systems and displacement gyroscopes for the Minuteman and Peacekeeper intercontinental ballistic missiles and most of the Air Force's aircraft" (16:1). Its FY1994 depot workload consisted of around 900,000 man-hours, and nearly 10,500 items were produced to support the requirements for 66 Air Force, Navy, and Army systems and components (16:2).

The AGMC's second mission, metrology and calibration, consisted of the technical direction and management of the Air Force Metrology and Calibration Program and operation of the Air Force Measurement Standards Laboratory. In fiscal year 1994, the standards laboratory was involved in the production of around 11,500 calibrated items (16:2).

During the Base Realignment and Closure Commission's actions of 1993, Newark AFB was placed on the base closure list because of its low relative military value to the DoD. Newark had no airfield for operations and existed solely to support the AGMC complex, employing about 11,700 civilian personnel (40:1). However the DoD considered that all of the work performed at AGMC to be core logistics capability. This is extremely important since the decision to outsource core workloads runs against the strategic plans established by the Secretary of Defense and is counter to actions in commercial industry.

Faced with the inevitability of closing Newark AFB and transferring the depot workloads to the remaining Air Force Air Logistics Centers, the DoD chose to privatize operations at Newark in a move known as privatization-in-place. Only four systems, sextants, ARC-200 radios, clocks, and some test measurement and diagnostics equipment, were deemed cost effective to transfer to other Air Force depots. These systems represented about 3 percent of AGMC's existing depot workload.

Likewise the decision was made to maintain the metrology and calibration mission at AGMC rather than transfer the workloads to either Army or Navy facilities performing similar services (16:10). The Air Force would retain ownership of the metrology and calibration equipment which was mission related and planned on

supplying this equipment, as government-furnished property, to contractors who would perform the work at Newark AFB.

Unfortunately privatization-in-place can actually privatize depot excess and cause the unit price of remaining public depot workload to increase. According the GAO, a public depot with thousands of employees incurs fixed costs in the range of \$50 to \$100 million annually (23:7). By moving some workload from a depot with excess capacity into the private sector, each unit's share of overhead expense at the depot can substantially increase and therefore increase the unit cost for all work done by that facility. In this way privatizing excess capacity makes the public depots even less cost effective and sets the stage for future depot reductions. These unit cost increases are not taken into account when the DoD calculates the cost of privatization-in-place.

A briefing by Defense Science Board Task Force on Privatization and Outsourcing also specifically recommends against privatizing-in-place since it, "often results in the preservation of surplus capacity" (8:61). As was the case with Newark AFB. Under the unexecuted plan of Newark's total closure, the elimination of Newark AFB would have cut around 1.7 million hours of capacity from the then Air Force-wide excess of 8.7 million. The closure and relocation expenses calculated by DoD showed that closing Newark AFB would produce one-time costs of \$31.3 million. DoD also estimated that under contractor operations, annual operations expenses would decrease to \$68.09. These expenses coupled with \$71.84 million in net annual savings in personnel and overhead would contribute to annual savings of \$3.8 million, thus producing an 8-year payback period for outlay costs (16:3). Government Accounting Office estimates were not as optimistic, forecasting that closure costs would be \$38.29 million, resulting in

a 13-year payback period. Nevertheless, according to the GAO, "BRAC permitted the Newark AFB workload to either be contracted out or privatized-in-place at the same location" (16:3).

Unfortunately under the chosen option of privatization-in-place, no such savings seem likely. In 1994 it was estimated that Newark's closure costs would increase to \$62.2 million or more, since over \$30.5 million in transition costs were not included in the original estimate (16:6). Transitioning to private operations costs considerably more than estimated largely because of poor DoD experience in forecasting those costs and the lack of time available to compile the estimates at the time of BRAC (16:6).

The GAO also determined that depending on the discount rate used in the algorithm for computing return on investment, the payback period for the privatization of Newark AFB could be around 100 years (16:7). However this new payback period is only valid if there is no further increase in the one-time closing costs associated with the base and if the AGMC can achieve operating cost savings of \$3.8 million per year. The GAO suggests, "neither of these assumptions is likely because of significant cost uncertainties" (16:7). As of 1995 over \$3.6 million had been identified for environmental cleanup and over \$4.8 million had been identified as necessary to cover interim health benefits, neither of which was funded by BRAC (16:7).

In December 1995, despite the published concerns from the GAO, Rockwell International was awarded the contract to perform depot-level maintenance and repair with an estimated contract cost of \$264 million. In addition, Wyle Laboratories won the estimated \$19 million metrology workload contract. To perform the work, almost 700 of

the initial 11,500 personnel assigned to Newark AFB before closure transferred to Rockwell International and around 100 transferred to Wyle Laboratories (40:1).

The likelihood of achieving \$3.8 million annually in savings is small considering the type of contract vehicle selected by DoD. The privatization-in-place implementation at Newark AFB was accomplished through the use of a cost-plus-award-fee (CPAF) contract. As noted in the Government Contract Guidebook the contract consists of two parts:

(1) a fixed amount that does not vary with performance and (2) an award amount in addition to the fixed amount sufficient to provide motivation for excellence in contract performance in areas such as quality, timeliness, ingenuity, and cost effectiveness. The amount of the award fee to be paid is based on a subjective evaluation by the Government of the quality of the contractor's performance, judged by the criteria set forth in the contract. (1:4-20)

In order to ensure equitable treatment of former government employees and fully reimburse contractors for unanticipated costs out of pocket, the CPAF contract was chosen. The CPAF compensates the contractor for having to hire former government workers and match benefits to those previously obtained under the public depots. These costs are over and above those planned during BRAC proceedings. The GAO reported that projected FY 1997 costs for AGMC under privatization-in-place were 107 percent higher than projected costs under government control (16:8). In addition, the projected contractor costs for the 5-year period FY96- FY00, "were estimated to be over \$456 million more than previously estimated costs of government operations over that period" (16:8).

Clearly under a CPAF, the risk of cost overrun is borne almost exclusively by the government. However the government's failure to correctly identify all costs in the past

nearly mandated this type of contract. The question that remains is whether operating costs are now truly higher or simply better accounted for by the contractors. Certainly costs are more traceable by the government under privatized operations, however the DoD still has a requirement to track its own costs at remaining public depots. If we are awarding cost reimbursement type contracts, such as the CPAF, it seems apparent the DoD must strictly account for its costs prior to privatization in order to measure contractor performance following.

Newark AFB is now fully privatized and lessons learned with regard to privatization and outsourcing efforts are still being compiled. Certainly the fact that Newark was on the BRAC closure list 2 years prior to Kelly AFB and McClellan AFB, was not advantageous to all. Fortunately, however, the DoD and commercial development corporations around Sacramento and San Antonio were able to glean some lessons learned from work in progress at Newark and prevent many of the same mistakes.

#### **McClellan AFB and Kelly AFB**

In 1995, at the time of the last round of BRAC realignment and closing actions, McClellan had about 7,314 personnel and Kelly AFB about 12,850 assigned to their respective Air Logistics Centers. The two centers accomplished about \$1.65 billion of depot maintenance work annually, "about \$400 million of which belongs to other services and is done through interservicing" (17:5).

Faced with losing so many jobs and in an effort to minimize the effects on the surrounding communities, the President, when presented with the BRAC recommendation of closures, again indicated the ALCs should be privatized-in-place or in

the local communities (17:5). “He also directed the Secretary of Defense to retain 8,700 jobs at McClellan AFB and 16,000 jobs at Kelly AFB until 2001 to further mitigate the closures’ impact on the local communities” (17:5).

The efforts to privatize-in-place at the San Antonio Air Logistics Center bring the same arguments about decreasing excess Air Force depot capability. By closing Kelly and consolidating military unique engine repair at the remaining public depots, excess capacity could be reduced, decreasing overhead rates and reducing engine repair costs. In a report to Congress, the GAO stated that savings of about \$182 million annually could have been achieved by transferring Sacramento’s and San Antonio’s depot maintenance workloads to the remaining public depots, which had 45 percent excess capacity (21:4).

However, by using the DoD practice of privatizing-in-place, no excess capacity would be diminished, hence the GAO determined it is, “unlikely that privatizing additional workloads would be cost effective--without first addressing DoD’s excessive capacity problem” (23:7).

### **Methods of Privatization**

The initial acquisition strategy for privatizing the workloads at Kelly and McClellan involved breaking work into five prototype workloads. These prototype workloads, three from Sacramento and two at San Antonio, involved about 11 percent of the Kelly depot maintenance personnel and 27 percent of the McClellan personnel (17:11). Table 2 below shows the annual value and number of workers involved in each of the five proposed prototypes.

**Table 2**  
**Privatization in Place Prototype Program Overview (17:11)**

<b>Dollars in millions</b>			
<b>Center</b>	<b>Workload</b>	<b>Annual Value</b>	<b>Workers</b>
Sacramento	Hydraulics	\$43	328
Sacramento	Electric accessories	\$38	212
Sacramento	Software	\$30	343
San Antonio	C-5 paint/depaint	\$20	143
San Antonio	Fuel accessories	\$73	440
<b>Total</b>		<b>\$204</b>	<b>1,466</b>

The DoD began to question the prototype concept shortly after the Defense Depot Maintenance Council approved the plan. The GAO reported, "community and industry groups expressed an interest in having larger packages, and DoD officials were concerned about the cost of administering a large number of smaller contracts" (17:11). Larger contracts permit contractors to take advantage of economies of scale and utilize service bundling in order to increase efficiency and drive down costs. The idea of dividing initial workload offerings into five smaller contracts would permit little bundling, unless a single contractor won more than one contract. Thus in May 1996, the prototype strategy was placed on hold, while the Air Force considered other options (17:12).

#### **San Antonio Air Logistics Center**

In August 1996, the Defense Depot Maintenance Council approved the revised acquisition strategy, consisting of larger work packages at both San Antonio and Kelly.

A two stage approach is now planned for the privatization of the depot at San Antonio in an effort to wait out new legislation and provide larger workloads. The two business areas currently under review for privatization are the C-5 aircraft business area and the engine business area (17:12). The request for proposal (RFP) for the C-5 business area outlines employment opportunity for approximately 1200 people in repair and support jobs, with an estimated value of \$155 million annually.

Currently the contract is planned as a fixed-price contract with economic price adjustment and award fee. The Government Contract Guidebook describes the fixed-price contract with economic price adjustment as follows:

This contract arrangement provides for a fixed price which may be adjusted either upward or downward based upon certain contingencies what are specifically defined in the contract. For example, the adjustment may be based on an increase or decrease in the national (or a local) wage or material index, the "wholesale price index, or some other appropriate standard. (1:17)

The award is offered as an incentive to the contractor to perform in a certain manner. According to the C-5 Business Area Public/Private Competition, RFP F41608-96-R-0254, "the contractor may earn a total award fee amount of up to 3% of the Firm Fixed Price Line items (CLINs 0001, and 0004-0010) delivered on the basis of performance during the evaluation periods" (44:2). In this circumstance, contract line item 0001 is pre-production and management staging, consisting of "activities occurring after contract award, but prior to offeror's assumption of any Work In Process (WIP)" (44:3). Furthermore contract line items 0004-0010 are the contract requirements for FY 1998 through 2004 (a 7 year contract) (44:3).

Of particular note is the fact that public/private competition will be utilized in the bidding process. If a public offeror wins the competition, the depot work must move

from Kelly to one of the remaining Air Force depots in order to comply with BRAC guidance. A private contractor would be forced to remain at Kelly, but would have access to government furnished property, including the aircraft repair facility with the "world's largest freestanding hangar, capable of housing six C-5s simultaneously" (45:1). According to Major General James Childress, commander of San Antonio ALC, the advantages of privatization are plentiful:

A privatization decision could offer many of our ALC civilian employees the opportunity to continue working in the same facilities, the same or similar jobs and using the same equipment--but for a private contractor. A private contractor would also have substantial opportunity to bring in commercial work to spread overhead costs resulting in more efficient maintenance operations and reduced costs to the Air Force. (45:2)

Thus should the government win the contract, costs would be incurred to build suitable repair facilities at another depot, where excess man-hour capability exists. However if a private contractor wins, they will be forced to relocate to Kelly, but could bring other work with them. This action could create excess in that contractor's present facilities. Of interest will be the methods used to compare private and public costs, especially costs to close or transition the facility to a new location. The decision on the competition should take place in the summer of 1997 (45:1).

Given the task of determining the cost to move the work currently performed at San Antonio and Sacramento to the three remaining ALCs, the GAO determined that it would cost about, "\$475 million to absorb all of the 10.5 million direct labor hours currently available for relocation" (17:8). Since the projected savings could be as much as \$206 million annually, "net savings would occur within 2-1/2 years of the consolidation" (17:8). In addition, since \$318 million of the projected \$475 million are

derived from the release or movement of depot maintenance personnel, the costs are incurred under either privatization or consolidation options (17:9).

Unfortunately as mentioned earlier, any large scale privatization plans affecting either San Antonio or Kelly directly conflict with the 60/40 rule of Section 2466 of Title 10. As a result, the DoD is now more anxious than ever to repeal legislative restrictions on intensive privatization efforts. Major General James Childress explains:

We cannot fit all the propulsion work under current 60/40 limitations. The propulsion competition will trail the C-5 by about six months. Between now and next summer [1997], we will be working the propulsion areas to try to figure how much we can compete. There will also be new initiatives to get this rule changed in the next Congress. (44:2)

If the 60/40 restrictions are not removed, Air Force planners predict that only about \$600 million of the two depot's \$1.65 billion workload will be eligible for transfer to the private sector (17:12). The GAO also points out that the remaining \$1.05 billion would have to be transferred to other depots. This massive transfer to the public depots would have the immediate effect of lowering their labor rate for all workloads nearly \$6.00 per hour and effectively decreasing Air Force depot excess capacity from 46 percent down to eight percent (17:8).

#### **Sacramento Air Logistics Center**

Plans for privatization at McClellan AFB involve a slightly different methodology following a decision to not proceed with the three prototype strategy. After applying lessons learned from the Newark privatization and evaluation of possible prototype approaches, the Air Force is combining the individual workloads consisting of hydraulics, electrical accessories, aircraft, software, instruments/electrical and

backshop/manufacturing into a single acquisition requirement (43:1). The DoD is seeking one source for the entire workload with the focus of the acquisition on re-engineering, process improvements, and cost efficiencies of combining processes.

The McClellan plan includes a 3-phase approach to transferring the workload to public or private offeror. In a Request for Information (RFI) published by McClellan ALC the three phases were described as follows:

Phase I: The Air Force issues a Request for Proposal (RFP), evaluating offerors' capabilities to perform the contract and past performance record. The Government will then select the best public and private offerors for award of study contracts. The study phase contract will be firm fixed price, the government will set the price, and the cost will be the same for all offerors.

Phase II: Actual 9-month study period will take place. The purpose of the study contracts is two-fold (1) to allow offerors to review and improvement upon the Air Force's current processes and (2) to allow offerors to perform due diligence studies to reduce inherent cost and performance risks. Offerors who are awarded study contracts will be teamed with a knowledgeable contingent of government employees to assist in learning the government's processes. Offerors will rotate through different workload areas to perform their study/due diligence. Each offeror will be allowed to be in a specific area during a specific time so as not to overlap with another offeror's study. During this phase, the RFP team will periodically meet with each offeror to discuss their progress and gain input for the formulation of the performance contract solicitation. The offerors who participate in the study contracts will submit in-depth technical, cost, management and past performance risk proposals, with emphasis on technical improvements resulting from the studies. After evaluations, the Government will select the one offeror whose proposal represents the best value to the Government. A deliverable from the study contract will be a process re-engineering study for the purpose of awarding the single, overall performance contract.

Phase III: One performance contract will be awarded to the offeror (public/private) who has demonstrated their capability to perform the requirements and provide the best value to the Government. Offeror's proposals generated in Phase II will be evaluated against the standards set forth in the solicitation (which will include process improvements and re-engineering) as well as offerors' past performance. One offeror's proposal will be deemed the best value for the government. The best value determination will be based on source selection procedures in accordance with the FAR and may or may not be based on the lowest price. (43:2)

The three phase acquisition strategy involving the study contracts is outlined below in Figure 5.

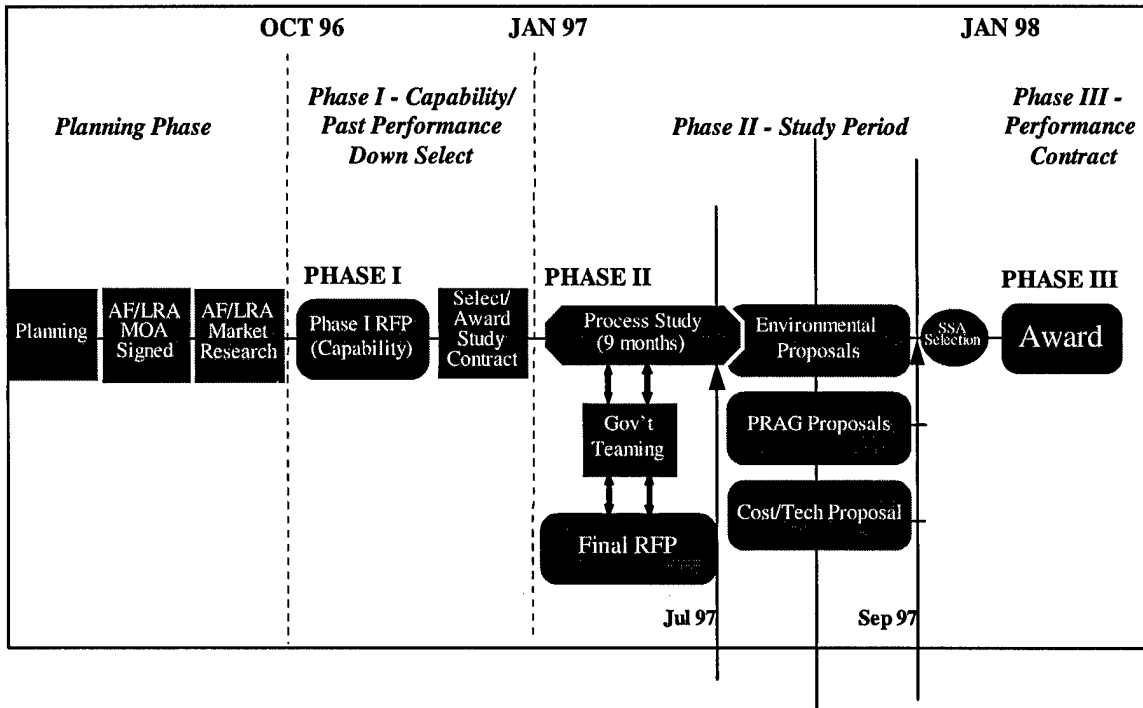


Figure 6: Sacramento Air Logistics Center Acquisition Strategy (42:39)

The study approach is intended to give two selected private and one public offeror the opportunity to participate in a joint, liaison approach, while under contract with the government. Together with acquisition, engineering, environmental, system manager and operating command team members, the offerors will jointly explore ideas for "process improvement, re-engineering, lean logistics, efficiencies, and commercialization/transition" (42:32). Ideas are presented orally and subsequently are reflected in the final RFP for actual depot workload performance--the end product of the study phase (42:32).

On Feb 7, 1997 the Air Force announced that Boeing North American Aircraft Division (Boeing) and the AAI Engineering Support, Inc. (AAI), "are the two private contractors selected to conduct the study contract completing phase I of the Sacramento

Air Logistics Center depot workload competition approach” (38:1). The commercial study contracts themselves are firm-fixed price contracts for a specified amount of \$750,000, with a performance period through September 15, 1997 (38:1). Ogden Air Logistics Center at Hill AFB, Utah was selected as the public bidder to perform its own competitive study effort.

Amazingly the public offeror is not allowed to team with other public depots in order to perform the workload, and all workload must eventually move to that depot facility. This contract restriction runs contrary to the GAO recommendation for pooling displaced work, either by interservicing or transferring to remaining Air Force depots (17:5).

### **Chapter Summary**

This chapter presented a very brief historical look at the privatization of depot workloads at Newark AFB, and then outlined the ongoing efforts at Kelly AFB and McClellan AFB. The Newark AFB closure was the first Air Force attempt at large scale privatization, and privatization-in-place has proven significantly more costly than other alternatives including shifting the work to other public depots.

Experiences at Newark, and two more years of industrial and DoD inputs have resulted in modifications of privatization plans for San Antonio and Sacramento Air Logistics Centers. While initial plans focused on smaller prototype workloads, current strategies look for encompassing larger workloads--contained in size only by legislative restrictions such as the 60/40 rule.

While current privatization-in-place strategies are moving away from cost-reimbursement contracts, the problem remains that the DoD has excess depot capacity. If costs of privatizing-in-place increase over current depot operating costs (as proven at Newark), and if privatization-in-place forces the public depots to become even less cost-efficient per unit output because of the need to spread the same overhead over fewer items, then these costs may negate any expected savings due to privatization.

The new depot structure may end costing more than it currently does and carry with it risks due to poorly written or administered contracts. In addition, if the attempt to privatize the excess capacity in the public depots forces even more public depots to close, the capability to provide organic support may be lost.

## **V. Conclusion**

### **Chapter Overview**

In this chapter the investigative questions introduced in Chapter I are restated and answered. The answers draw upon information presented throughout this research paper. The chapter concludes with a summary of the research paper.

### **Investigative Question One**

#### *1. What do we mean by privatization and outsourcing?*

Many definitions of privatization and outsourcing exist, but most are variations upon central themes. Outsourcing is what we would normally consider “contracting out”. A service provider is selected as the result of competition, and the resulting contract is subject to periodic recompetition (8:7). Normally outsourcing does not involve the transfer of extensive amounts of government furnished property.

Privatization, conversely, is a subset of outsourcing wherein the transfer of significant government assets to the private sector is required to fulfill the requirements of the contract (8:8). These transfers may occur because of the desire to shrink the size and extent of government, or simply in an attempt to find service providers who can provide the services at better quality and lower cost (25:31).

### **Investigative Question Two**

#### *2. Why does the government want to privatize its depots?*

Changing world conditions beginning around the mid-1980s and other factors have significantly reduced the DoD depot maintenance requirements. In addition the

private sector, which is experiencing a similar decline in its production workload for new weapon systems, is seeking more of the available defense dollars for depot maintenance. As a result of BRAC actions in 1993 and 1995, the Air Force has been forced to evaluate the necessity of closing Newark, Kelly, and McClellan Air Logistics Centers and either transferring workloads to other public depots or instituting privatization.

Privatization-in-place was directed by President Clinton in order to "1) avoid the immediate costs and disruption in readiness that would result from relocating of the air center's mission, 2) mitigate the impact on the local communities, and 3) preserve important defense work forces" (21:17). However the GAO, the Defense Science Board, and industry representatives feel that privatization-in-place does nothing to solve the excess capacity problems within either the public or private sector, and thus "inhibits the realization of cost savings intended from base closures and the performance goal improvements that privatization is intended to achieve" (17:10).

The government desire to privatize springs from the validity of the three assumptions: 1) the military is inefficient in non-core capabilities; 2) private industry has the capability and the interest in performing depot contracts and will do so more efficiently and cost effectively than the public depots; and 3) privatization "savings" will be funneled back into modernization efforts for the DoD. By choosing to proceed with privatization, the government is presupposing the all three assumptions are valid in the current depot and political environment.

However the fact is that the military may not always be more inefficient and no evidence of a vehicle exists with which to funnel "expected" savings back into modernization. With depot privatization-in-place costing more than previously under

public depot control, the assumptions simply do not pass the sanity check. Privatization may hold the key to reduced cost, but privatization-in-place does not appear to offer the same cost advantages.

### **Investigative Question Three**

*3. What are some of the institutional and overarching impediments to privatization of the public depots.*

Various barriers stand in the way of successful privatization from both statutory restrictions and organizational perspectives. First and foremost, numerous legal restrictions effect the degree to which depot-level workloads are eligible for transfer to the private sector. They include, among others, Title 10, United States Code (U.S.C) 2464, 10 U.S.C. 2466, and 10 U.S.C. 2469. Taken together, these three statutes require DoD to: 1) maintain its own depot-level repair capability at an unspecified "core logistics capability" (23:6); 2) not expend more than 40 percent of the funds made available in a fiscal year for depot-level maintenance/repair for private sector performance (23:6); and 3) conduct "merit-based selection procedures for competitions" among public and private depots for workloads valued at over \$3 million (21:6).

The combined effect of these three statutes limits workloads available for transfer to private industry. This limitation in turn reduces market efficiencies that the private sectors stands to benefit from through larger workloads. In addition it forces the competition between public and private depots where the uneven playing field makes direct competition difficult, especially with the lack of a common cost accounting system between public and private.

Competing public and private depots brings up the fact that as more and more public depots are privatized-in-place the public depots will become even less cost efficient. As fixed overhead costs are spread over fewer items, unit cost of production at the public depots will increase (23:7). In the future event of public/private competitions, public depots will likely become less competitive unless excess capacity is eliminated. In addition, if the move to privatize-in-place the excess capacity now held in the public depots forces even more public depots to close, the capability to provide organic support may be lost.

On the other hand, the DoD requires a strong industrial defense base to provide technology, research and development, and production capability for modern weapon systems. Healthy competition between private firms keeps prices lower and encourages innovations and process improvements. If the DoD does nothing to ensure the survival of sufficient numbers of private contractors for future work, the capability in industry may move to support other endeavors.

Another barrier arises from the question of risk. Evidence from the Congressional Budget Office suggests that the presumption that only public depots could provide the level of depot support required "does not appear well-founded" (33:38). With the advent of long-term strategic relationships using well-written and administered performance contracts, the DoD could mitigate most risks. However this need to embrace privatization and outsourcing as core competencies requires a culture shift, which the Air Force, and other large organizations have difficulty accomplishing (4:42).

Other barriers include the fact that to truly obtain efficiency in organizations, the firms must expand business in order to share fixed-costs over a larger base, or pay people

less, or have fewer people do the work (29:62). The attempts on the part of the government to cushion the fall of thousands of public depot workers is admirable, and perhaps necessary, but nevertheless adds excessive costs to a program designed to provide savings for modernization.

#### **Investigative Question Four**

##### *4. How are we currently privatizing depots and depot workloads?*

Newark AFB was the first Air Force attempt at large scale privatization. Unfortunately, due to the privatization-in-place strategy, poor cost forecasts, and the need to use a cost-plus-award-fee contract, actual base closing and privatization costs have overshadowed any savings.

Privatization efforts at Kelly AFB and McClellan AFB enjoy the experience gained from Newark's privatization attempts, however both are mandating privatization-in-place if a private service provider wins the public/private competition. If a public depot wins the competition, that depot must absorb all of the associated work without shifting any to another depot or outsourcing to a commercial provider. Strategies for both air logistics centers initially planned on using small prototype privatizations in order to pass work in stages to one or more contractors (17:11). However, recently revised strategies have departed from this original plan in order to pass larger workloads to prospective performers.

San Antonio ALC has released an RFP for its C-5 workload, offering a fixed-price contract with economic price adjustment and award fee. The contract is anticipated to employ approximately 1200 people and be worth approximately \$155 million annually

(17:12). Release of a subsequent RFP for Kelly's propulsion workload is scheduled for mid-1997 since legislative restrictions, such as 10 U.S.C. 2466, still limit the workloads to the private sector.

At the Sacramento ALC, the privatization initiative is using a 3-phase approach. In February 1997, following Phase 1 - Capability/Past Performance Downselect, the DoD awarded fixed-price study contracts of \$750,000 to Boeing and AAI. DoD also designated Ogden ALC as the public bidder, responsible for performing its own study (38:1). Under Phase II, the three offerors will become familiar with the workloads available for competition, "understand current maintenance process and systems; and identify areas for improvement" (38:1). The contractors will also explore business development approaches for reducing costs and adding value to the Phase III Performance Contract. In addition the offerors will identify ways to transition the workload at low-cost and low-risk, in a way that maintains mission readiness.

#### **Investigative Question Five**

##### *5. What problems are we still experiencing ?*

Privatization plans at San Antonio and Sacramento Air Logistics Centers seem to be addressing the need to compete private against public depots prior to the transfer of workloads, but numerous issues have not been addressed and solved.

What is still not being addressed is the need to reduce excess capacity. Only by closing depots and redistributing workloads either to private industry (at a place and choosing of the service provider) or to the remaining public depots, can DoD reduce its excess. Numerous statutes still remain as public depot protection measures. Without

their repeal, workloads cannot be effectively shifted to the private sector in packages that will provide work efficiencies.

Along with the elimination of excess capacity comes the need to re-evaluate our risk assessments. If all risk assessments to date have been accomplished using past depot structures and capabilities, DoD must reanalyze the mission-essential workloads to determine what effect the closures of Newark, Kelly, and San Antonio have. Is there more risk while work is privatized under a private contractor in-place, or is the greater risk taken by transferring workloads to the remaining public depots and reducing excess from 44 percent to 8 percent (21:4)? Evaluating these risks should be an immediate DoD objective.

DoD must also find a way to accomplish credible cost analysis. Cost analysis in order to compare public/private competitions and in order to monitor performance following contract award is crucial (11:33). Without knowing the true costs of current operations, how can we critically evaluate private depot performance while under contract, or even the public depots' actual efficiency?

### **Research Paper Summary**

The DoD is approaching privatization of depot maintenance for the purpose of saving money to modernize our aging defense forces. The Defense Science Board reported that approximately \$30 billion per year could be shifted from support to operational forces using privatization, among other recommendations (13:1). As a small part of this overall strategy, privatization of the depots was expected to bring \$1.2 billion savings over the next five years. Although it is still too early to fully evaluate the results

of ongoing privatization, this much is true--privatization-in-place at Newark AFB has produced no discernible savings--only cost growth.

The Defense Science Board study team reported that, "privatization-in-place should be avoided, since it tends to preserve excess capacity (17:10). By choosing to privatize-in-place, the government is doing nothing to decrease excess capacity and improve cost efficiencies. In fact many of the political barriers currently in place still cannot permit optimal privatization efforts. Legislative restrictions still protect the public depots at the expense of higher cost and lower efficiency. RFPs for workloads require private contractors to perform in-place, but prohibit public pooling--the original GAO plan for distributing workloads to remaining centers. Clearly the culture change has not happened when the DoD readily embraces privatization and outsourcing, with its benefits and risks, in order to achieve its professed savings. It appears the DoD is jeopardizing any cost savings that industry may have been able to pass back for modernization efforts.

The DoD will get only one chance to effectively privatize in order to achieve savings. Seven years from now if the Sacramento ALC contracts come up for recompetition, the DoD will not have maintained the capability to recompute against a private contractor. Wiley Pearson, defense policy analyst for the American Federation of Government employees, cautions: "Once you pull out [of depot maintenance], you lose your work force, your expertise, you sell you tooling and your infrastructure" (72:14). In the words of Dr. Craig Brandt, from the Air Force Institute of Technology, "Privatization is a one-way street--there is no going back" (2). DoD has only one chance to reap real savings from privatization, and these savings clearly are not possible under government directed privatization-in-place.

Are we privatizing depot maintenance workloads in the best way possible?

Experience has taught me that manufacturers are now as necessary to our independence as to our comfort. (26:2)

Thomas Jefferson

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## Vita

Major James A. Spaulding graduated from the United States Air Force Academy, on 29 May 1985 with a Bachelor of Science in Management. On 15 July 1985, he reported to Mather AFB, California to attend Undergraduate Navigator Training. Major Spaulding graduated from navigator training and moved to McChord AFB, Washington to fly the C-141 in June 1986. He flew numerous airdrop and Special Operations Low Level I missions, including Operation JUST CAUSE. He also served as Executive Officer and Wing Tactical Training Officer.

In October of 1990, Major Spaulding moved to Altus AFB, Oklahoma as a C-141 schoolhouse instructor and Quality Assurance Representative, providing oversight for the C-141 Aircrew Training System contract. While at Altus AFB, he augmented 322d Airlift Division at Ramstein Air Base, Germany for Operations DESERT SHIELD and STORM and flew numerous support missions. He also received his Master of Arts in Computer Resources and Information Management from Webster University.

In August 1993, he moved to McGuire AFB, New Jersey where he planned and flew Distinguished Visitor support missions, served as Group Standardization/ Evaluation Navigator, and worked as Chief, C-141 planner for the forced entry plan into Haiti for Operation UPHOLD DEMOCRACY. In February 1996, he was selected to attend Air Mobility Command's third class in the Advanced Study of Air Mobility. Major Spaulding has a follow-on assignment to Stuttgart Air Base, Germany serving European Command in Plans and Programming.

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